DOCKET FILE COPY ORIGINAL

RECEIVED

AUG 25 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 93-215
	)	
Rate Regulation	)	

COMMENTS OF CONSUMER FEDERATION OF AMERICA

Dr. Mark Cooper
Research Director

Gene Kimmelman
Legislative Director

Attorney for Consumer
Federation of America

Consumer Federation of America
1424 16th Street, N.W., Suite 604
Washington, DC 20036

August 25, 1993

No. of Copies rec'd 0+9
List A B C D E

RECEIVED

AUG 2 5 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of)
)
Implementation of Sections of)
the Cable Television Consumer) MM Docket No. 93-215
Protection and Competition Act)
of 1992)
)
Rate Regulation)

COMMENTS OF CONSUMER FEDERATION OF AMERICA

INTRODUCTION

CFA[1] hereby submits these comments in the above captioned proceeding regarding the regulatory requirements that will govern cost-of-service cable rate challenges ("Notice"). Although CFA remains concerned that the Commission has failed to squeeze all monopolistic excess from cable rates[2], we commend the Commission for proposing cost-of-service guidelines that should provide a reasonable backstop to the benchmark regulatory system.

I. THE PHILOSOPHY OF BACKSTOP COST OF SERVICE REGULATION

In general, the Commission has done a good job in outlining

[1] Consumer Federation of America (CFA) is coalition of 240 pro-consumer organizations with some 50 million individual members. Since 1968, it has sought to represent the consumer interest before federal and state polymaking and regulatory bodies.

[2] See Comments and Reply Comments of CFA In the Matter of Implementation of the Cable Television Consumer Protection and Competition Act of 1992, MM Dkt.No 92-266, Jan 27, 1993 & Feb 11, 1993.

a cost-based backstop for its benchmark approach to regulating rates. However, there are several areas in which it must remain vigilant to prevent the cost-based backstop from becoming an avenue for abuse.

First, the Commission must not streamline the backstop to the point where all cable operators simply opt to challenge the benchmark (Notice at 13). The Commission must make the cost-based proceeding a rigorous cost analysis.

The "traditional formulation... to govern cost-based rates for cable service (Notice at 12)" should be interpreted in the strictest fashion. The legal background for traditional regulation, as cited by the Commission, is quite firm and the Commission could have chosen this well-tested path as its primary mode of regulation. In providing a backstop for its streamlined approach, the Commission should feel no obligation whatsoever to compromise with the tried and true principles of traditional, cost-based regulation.

II. EXCESS ACQUISITION COSTS

Second, the Commission must not allow the cost-based proceeding to become an avenue for cable systems to recover excess acquisition costs. Cable rates became vastly inflated under the umbrella of monopolistic pricing. The Commission cannot allow these monopolistic abuses to become institutionalized (Notice at 13).

We have demonstrated amply in our previous comments that these excess acquisition costs are nothing but expectations about the exercise of monopoly power[3]. The Commission recognizes that this is the primary driving force behind excess acquisition costs (Notice at 22).

The Commission should allow no excess acquisition cost recovery except, consistent with U.S. Constitutional protections, to avoid the financial bankruptcy of a system. The Commission may call this a "transition mechanism" (Notice at 22) to relieve cable operators who can demonstrate severe financial distress. The recovery of these excess acquisition costs should be allowed only for the purpose of avoiding bankruptcy, and should be constrained to the absolute minimum necessary to achieve that narrow objective.

III. ESTABLISHING THE RATE BASE

This position regarding acquisition costs is consistent with the general philosophy adopted by the Commission in choosing traditional cost of service regulation. It is also consistent with the specific position adopted by the Commission to include in rate base only investment that meets a "used and useful and prudent investment standard" (Notice at 18) based on "an original cost methodology to determine the value of a cable operator's plant in service for rate base purposes" (Notice at 20).

Following the clear logic of traditional cost-of-service regulation, excess capacity, cost overruns and premature abandonment (Notice at 23) should not be recovered from cable

---

[3] See Comments of CFA, op. cit.

subscribers. Such costs represent a mixture of imprudence and entrepreneurial risk (which is already richly rewarded in the rate of return). The burden of these costs should be borne by the stockholders of the franchise company, not its rate payers.

Similarly, costs such as "prospective capital expenditures used to improve the quality of service or to provide additional services" (Notice at 40) should be rejected. Such costs are speculative, not used and useful and are not typically recovered in a competitive marketplace. The costs of providing new services, in particular, cannot be recovered from old customers, since competitors would quickly steal these customers.

IV. RATE OF RETURN ON PROGRAMMING

There is absolutely no reason that cable operators should be allowed to rate base the costs of programming. The predicate of the 1992 Cable Act was the existence of market power, which had been abused. Cable operators continue to possess that market power. Allowing a rate of return to be passed through to the captive customers of the operator would simply be an abuse of market power.

In a competitive marketplace, the programmer would have to offer services to all comers at a price the market would sustain. That price would include a normal return, but not economic profits. A programmer that exceeded the market price would lose business. Unfortunately the programmer, who is also a cable operator, can avoid this market discipline by bundling or otherwise giving preference to self-provided programming. Any rate of return allowed on programming above the market price charged to others would be supra-normal profits, unavailable in a truly competitive market.

V. COST ALLOCATION/RATE DESIGN

The Commission recognizes that the provision of multiple services with differing characteristics over common plant requires close attention to cost allocation. The Cable Act was quite explicit in prohibiting regulated services from being used as a cash cow to incrementally price unregulated services. The cost proceeding requires the Commission to go much more deeply into an analysis of costs to ensure reasonable cost recovery on regulated services.

The channel allocator adopted by the Commission, which is consistent with CFA's recommendations in our initial comments, is adequate as a starting point. However, as the industry offerings become more and more complex, especially with the possible addition of non-entertainment services, the Commission will have to develop a more complex theory of cost causation. Since many of the industry's plans for enhancements have only recently been announced, it is crucial for the Commission to identify costs as of the date the Act became law, and closely scrutinize more recently incurred costs.

VI. AFFILIATE TRANSACTIONS

The Commission has correctly identified affiliate transactions as a source of abuse. Such transactions should be "priced" at prevailing market prices paid by third parties. Where transactions are not frequent enough to give sound guidance, then the alternative suggested by the Commission is correct. The Commission should impute the highest price enjoyed by the cable system as a seller and the lowest price paid by the system as a purchaser to protect basic subscribers.

VII. RETURN ON EQUITY

The Commission's conclusion that the Standard and Poor's average should be used to set the return on equity is far too generous to cable operators. The bottom quartile of the S&P 400 would be more appropriate.

Few of the companies in the S&P 400 have the market power enjoyed by cable operators. The cable companies subject to rate regulation do not face real competition. They do not have a competitor serving half their market. They have achieved a market share in excess of 30 percent. To allow these companies to earn at the same level as the S&P 400, when there is such an obvious difference in the level of risk they face, violates the fundamental principles of traditional regulation invoked by the Commission (See the Hope and Bluefield legal test, outlined in CFA's previous comments[4]).

---

[4] See Reply Comments of CFA op. cit., at 51

VIII. PRODUCTIVITY ADJUSTMENT

CFA's original comments documented the cable industry's large increase in productivity[5]. The Commission should therefore assume that the cable industry has experienced productivity gains at least equal to those of the local exchange telephone companies (3.3 percent per year).

CONCLUSION

CFA believes the Commission has proposed a reasonable cost-based backstop for its benchmark cable rate regulatory system. By following traditional regulatory principles, the Commission's cost-based backstop should ensure that consumers' cable rates are reduced while cable operators substantive and procedural legal rights are fully protected.

Respectfully submitted,

Dr. Mark Cooper
Research Director

Gene Kimmelman
Legislative Director

Attorney for Consumer
Federation of America

August 25, 1993

---

[5] See Comments of CFA, op. cit., at 17-69